

A Region Divided: Transformation towards Democracy and Market Economy in Latin America and the Caribbean

Strategic Insights, Volume IV, Issue 12 (December 2005)

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Strategic Insights is a monthly electronic journal produced by the [Center for Contemporary Conflict](#) at the [Naval Postgraduate School](#) in Monterey, California. The views expressed here are those of the author(s) and do not necessarily represent the views of NPS, the Department of Defense, or the U.S. Government.

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Introduction



The resurgence of the political left in several elections and the political upheavals sweeping through the Andean countries in recent years has deepened worries that the gains made in transformation in Latin America over the past two decades are in danger. Both phenomena powerfully demonstrate the problems plaguing Latin America's development—problems in which

socioeconomic and political-institutional factors mutually reinforce each other. Hopes for increased stability in development depend upon the regional anchor states of Brazil, Chile and Mexico, all three of which were able to consolidate their level of transformation. Regional gaps on the subcontinent thus continued to widen: whereas political and economic development slightly improved in Brazil and the Cono Sur (Argentina, Chile, and Uruguay), the five Andean countries (Peru, Bolivia, Ecuador, Colombia and Venezuela) remain the problem countries on the continent.

Only countries with leaders demonstrating good or very good management could either advance transformation or at the bare minimum, stay their course in spite of significant challenges. The latter is especially true for the small countries, which, due to their economic structures and vulnerability to world markets, are particularly susceptible to fluctuations in the global economy (Uruguay, Costa Rica, Dominican Republic, Jamaica, El Salvador). Conversely, Haiti, Venezuela and authoritarian Cuba demonstrated clear failures in management and they continue to pose problems for transformation in Latin America.

In Venezuela, Hugo Chávez consolidated his power after surviving a putsch and a major general strike in 2002. He also won a successful mandate to continue his presidency in a constitutionally binding referendum held in 2004. Since 2003, Chávez has taken Brazilian President Lula da Silva's place as the key cult figure of the anti-globalization movement and critics of neo-liberalism. In fact, increasing uneasiness with the neo-liberal model of development was felt throughout Latin America while the region's political elites placed emphasis on new free trade agreements (particularly with the United States).

This report provides an overview on the state, trajectory and management of the transformation processes in the 21 countries in Latin America and the Caribbean. It is based on the results of the Bertelsmann Transformation Index 2006 (BTI) and the underlying country assessments which analyze each individual country in detail.

Democratic Development

Despite the somewhat spectacular events in Bolivia, Ecuador and Venezuela, democracy in Latin America remains stable. However, the region's most serious problems have deepened and are becoming increasingly visible. These problems are the consequence of insufficient economic reforms, enormous social inequity and the lack of stable institutions in the region's predominantly defective democracies. The lack of social progress made, coupled with the massive social demands articulated and the attractiveness of populism, constitutes a danger not to be ignored by the international community.

In general, Latin American democracies continue to suffer from a state monopoly on the use of force that is only partially secured, insufficient administrative structures and, most importantly, deficiencies in the rule of law. The region's prospects for stability are limited by the periodically poor performance of democratic institutions, but most of all by weak mediation between state and society and problems of empowerment in democratic civil societies. These weaknesses are linked to the continent's social troubles, particularly the problems of acute inequity and the concomitant imbalanced class structures found in most Latin American societies.

Table 1: The Quality of Democracies in Latin America

Democracy	Defective Democracy		Strongly Defective Democracy	Autocracy
Uruguay	Brasil	Peru	Colombia	Cuba
Costa Rica	Argentina	Honduras	Guatemala	Haiti
		Bolivia		
Chile	Mexico	Nicaragua		
	Panama	Paraguay		
Jamaica				
	El Salvador	Ecuador		
	Dominican Rep.	Venezuela		

Countries are listed according to classifications derived from the BTI scale and according to their BTI score in the status index for political transformation.

The quality of democracy in Latin America and the Caribbean varies significantly. Uruguay, Costa Rica, Chile and Jamaica represent a group of stable, well-functioning democracies under the rule of law. The bulk of Latin American countries are categorized as defective democracies with relatively stable political institutions. Civil liberties in these countries are limited by deficiencies in stateness and the rule of law. Haiti and Cuba have been classified as autocracies. Triggered by external pressure, President Aristide's demise in Haiti resulted in dramatic changes that could lead to renewed democratic transformation. However, scant political and social progress one year after Aristide's removal and the deployment of UN troops underscores the difficulty to establish more stable political conditions. To date, no free and fair elections have been held in Haiti. On the other hand, the Castro dictatorship on Cuba has further stabilized—in part due to Venezuelan President Chávez's support—and shows no signs of democratic change.

The strengths and weaknesses of Latin America's political systems remained essentially unchanged. Deficiencies in most countries' stateness continue to represent a fundamental obstacle to democratic and market economic transformation. Apart from guerilla warfare and the civil war currently affecting Colombia only, the state's monopoly on the use of force is increasingly "privatized" in the remaining countries (excepting Chile, Costa Rica, Uruguay, Jamaica, and Cuba). The problem results from the combination of insufficient state protection of the underprivileged, the penetration of the state apparatus by organized crime and the drug mafia's unrestrained expansion. These phenomena can be observed most clearly in Mexico, where despite the palpable political will to advance reform, police, military, public prosecutor's office and the judiciary are still so thoroughly penetrated by organized crime that the line distinguishing those protecting and those infringing upon the law is blurred.

In Brazil as well, groups with close ties to the drug mafia continue to operate as parallel structures to the state and undermine the state's ability to provide security. Paraguay and Central America in particular are affected by the problem of transnational criminal youth gangs whose activities have increased in recent years. The growing trend of transnational organized (drug) crime associated with weak state power has also continued in the Caribbean, which has become an important transfer point in drug smuggling.

No progress was made in enhancing the rule of law, which persists as the greatest weak spot in Latin American democracies. Only Uruguay, Costa Rica, Jamaica and Chile may be considered democracies under the rule of law. To differing degrees, the remaining countries are plagued by malfunctioning checks and balances, insufficient independence of the judiciary, and limits to civil liberties. This leads on the one hand to a lack of control over political power (Argentina) and on the other hand to a 'low intensity citizenship' for many citizens and/or the state's inability to guarantee citizens' fundamental rights (Guatemala). These negative trends are strengthened by the endemic levels of corruption in nearly all the region's countries.

The central obstacle to the overall stability of democracy in Latin America lies in the extent to which democracy is socio-politically embedded. In other words, the quality of the structures of representation, the vigor of civil societies supporting democracy and the pervasiveness of democratic standards is crucial to the stability of democracy. Only Uruguay and Costa Rica and to some extent Chile enjoy this stabilizing environment. In contrast, different combinations of weak civil societies, unconsolidated civic cultures and unstable structures of political representation are seen in each of the remaining countries.

Weaknesses in structures of representation and, more importantly, in political party systems affect primarily Peru, Ecuador, Bolivia, Venezuela and Guatemala. In these countries the democratic institutions are in danger to be damaged under the pressure of massive social demands. A similar problem could emerge in Argentina, where the public's alienation from the political elite has yet to be resolved. The country's established political parties have failed to undergo sufficient reform, and no new elite has emerged from the crisis as of yet. Haiti and especially Cuba face the problem that their still virtual processes of transition will be endangered from their inception by fragile modes of representation.

The region's predominantly weak civil societies are to be regarded as hurdles to democratic consolidation. For example, Bolivia and Ecuador's so-called popular putsches or "golpe popular" are deceptive in that they seem to suggest the presence of powerful civil societies in these countries. In fact however, they point to the threatening spread of anti-institutional policy. These movements undermine rather than solidify the foundations of democracy. Self-organizing civil societies that facilitate consolidation and a stable civic culture are found only in those countries with either a long democratic tradition and/or a relatively advanced level of development (these include Uruguay, Costa Rica and Chile, as well as Argentina, Brazil and Jamaica).

Market Economic Development

After the so-called "six lost years" (*sexenio perdido*, 1997-2003), the national economies of Latin America recovered as they gained from favorable global economic trends from 2003 to 2005. As exporters of oil and natural gas, Venezuela, Ecuador and Bolivia benefited from increased prices for raw materials. The fact that this boom period did not help them achieve any political stability whatsoever demonstrates the risk to which most countries knowingly expose themselves: Instead of using a relatively favorable international climate to advance reforms and invest in their economic future, these countries recklessly squander their ability to act, as was the case in Argentina and Mexico. Due to recent increases in world market prices, Latin America faces the risk of once again becoming an exporter of raw materials, with all of its concomitant political and economic problems. Most Latin American governments have yet to find a solution to this problem, which is linked to the opening of Asian markets, their growing strength in the manufacturing sector, and the strong demand for raw materials. Discussions regarding a more consistent development model, initiated first in the early 1990s by the UN Economic Commission CEPAL, must resume in Latin America—especially in light of the continent's meager social development.

Political forces calling for increased state intervention have actually grown in some Latin American countries due to the poor track record of economic and social development. Social and

political unrest in Bolivia, where some citizen movements have demanded gas production be nationalized, is symptomatic of these new trends. Following President Chávez' referendum victory, calls for state intervention has increased in Venezuela as well. Chávez' political and economic liaison with Castro and other foreign policy initiatives point to a strategy aimed at spreading his brand of anti-neo-liberalism. It remains unclear whether these currents will spread to other countries in the region, such as Ecuador or Peru, and whether the traditionally acute social inequity will combine with populism to an increased danger to market economic development ("Latino disease"). To date, regional heavyweights Brazil, Mexico, Argentina and Chile maintain the course of market economic transformation in Latin America.

Table 2: Levels of Market Economy in Latin America and the Caribbean

Developed market economy	Viable or functioning market economy	Market economy with functional flaws		Poorly functioning or rudimentary market economy
Chile	Costa Rica	Mexico		Venezuela
	Brazil	Panama	Dominican Rep.	Guatemala
		El Salvador	Bolivia	
	Uruguay	Argentina	Honduras	Cuba
		Colombia	Nicaragua	
		Jamaica	Paraguay	
		Peru	Ecuador	Haiti

Countries are listed according to classifications derived from the BTI scale and according to their BTI score in the Status Index for economic transformation.

On the whole, the patterns of market economic transformation observed in the 2003 BTI have continued through the period under review. Enjoying a solid economic regime and strong performance, Chile maintained its position at the top as a relatively well-developed market economy. Three other countries—Costa Rica, Brazil and Uruguay—may also be classified as having functioning and/or performing market economies. Despite growing problems, Costa Rica and Uruguay were able to stabilize their economy's performance and preserve relatively socially-balanced economic structures. Unlike Argentina, Uruguay lived up to the confidence expressed in it by the international financial community, the crisis of 2002/03 notwithstanding.

However, the majority of market economies in Latin America do not function well. This larger group is divided into two sub-groups of countries marked by qualitatively distinct development dynamics and prospects. The first sub-group includes on the one hand, small countries with a coherent regulatory framework, but relatively limited economic performance (Panama, Jamaica, El Salvador), and on the other hand, countries less dependent on market fluctuations thanks simply to the size of their economies (Mexico, Colombia). Having stabilized its economy after the 2001/2002 crisis, Argentina has rejoined the ranks of this group. However, it has yet to use its development level and its growth potential to effect a greater leap in transformation. In the second sub-group, market economic transformation continues to stagnate—albeit for a variety of reasons. In addition to Paraguay and the Dominican Republic, this sub-group includes two countries from the Andes region and Central America each. All these countries suffer from a continuing high incidence of poverty, moderate development levels, a large informal sector and other major structural deficits (infrastructure, social security systems).

Venezuela, Guatemala, Haiti and Cuba remain far behind in terms of market economic development. Cuba's relatively high level of development (based on HDI indicators) continues in the absence of any meaningful institutional framework for a market economy. Indeed, trends liberalizing some aspects of its state-controlled economy, such as in foreign trade and monetary transactions (dollar), have been reversed in the last two years. Nevertheless, Cuba was able to further stabilize its economy with assistance from Venezuela. Aside from the country's improved economic performance, Cuba's environmental, educational and technological sustainability are to be lauded. Thus far however, insufficient use has been made of the country's development potential.

Venezuela's unnecessarily bleak situation may be attributed directly to specific political decisions that the BTI characterizes as failed transformation management. This oil-rich country continues to profit from its immense oil revenues, but increasingly shows the hallmarks of a rent-seeking economy. In fact, the basic institutional framework has deteriorated over the past two years as a risky budgetary policy, an inadequate stability policy and restrictions to the central bank's autonomy demonstrate. Consequently, the prospects for Venezuela's private sector have weakened and investment has dropped drastically. The growing structural deficits exacerbated by populist budgetary policies may again lead to drastic macroeconomic adjustment policies in the medium-term.

All over the region, arrangements needed to ensure social equity and sustainability are insufficient and exacerbate the problem of limited development prospects for large parts of the population. With the exception of Costa Rica, Uruguay and, to a certain extent, Chile, welfare regimes in place throughout the region are generally rudimentary and appear to cement rather than alleviate social differences. In terms of sustainability, the lack of public spending on education in particular serves to increase and prolong the effects of inequity, as the best educational facilities are often private institutions. In Chile, this education deficit is regarded as its Achilles' heel to future success; yet despite increased spending, very little improvement has been registered.

Transformation Management

With the exception of Cuba, Latin America is the only region aside from Eastern Europe in which transformation management, since its inception in the 1980s, has been aimed in principle toward market economic and democratic reforms simultaneously. The difficulties inherent to achieving these dual goals simultaneously are exacerbated by the fact that reforms must be implemented in the face of firmly established interest groups with the capacity to block new policies. In recent years, new social movements have emerged in some countries (e.g. Bolivia, Peru, and Ecuador) and mobilized, sometimes radically, to resist further economic reforms. Particularly in those countries where transformation efforts have stalled, the prospects for reform appear bleak once again.

A comparison of the BTI values given for transformation management in Latin America presents a highly heterogeneous image. The transformation management of slightly more than one-third of the countries was rated as good or very good, while only four states clearly demonstrated poor governance. Between these two groups lies another in which nearly half of the countries are classified. In this median group, political elites demonstrated only partial success and in general proved incapable of setting a fundamentally new agenda. Argentina is emblematic of this limited dynamism, as it has undergone a recovery since 2003 under President Kirchner, but none of the needed economic and social reforms have been implemented.

Table 3: The Quality of Transformation Management in Latin America/Caribbean

Successful Management	Successful Management with deficiencies	Management with moderate success	Management with limited success	Failed or non-existent Management
Chile	Uruguay	Argentina	Ecuador	
	Brazil	Bolivia	Venezuela	Haiti
	Costa Rica	Dominican Rep.		Cuba
		Peru		
	El Salvador	Colombia		
	Mexico	Honduras		
	Jamaica	Nicaragua		
	Panama	Guatemala		
		Paraguay		

Countries are listed according to classifications derived from the BTI scale and according to their BTI score in the Status Index for political transformation.

[Table 3](#) also shows several shifts in the quality of management as compared to the 2003 BTI. Chile succeeded in maintaining its rather lonely position at the top, while Uruguay and Costa Rica dropped from the group of top performers. Their fall can be attributed to the fact that both countries failed to make effective use of their resources. In Costa Rica, a weakened ability to build consensus in the face of growing social crises was also a factor. El Salvador and Mexico's upgrade into the same group is attributed to their marked ability to engage in international cooperation. In contrast, the median group's four newcomers owe their upgrade to improved management in nearly all categories. It must be noted that, unlike the 2003 BTI, each of these four countries had new governments to be evaluated and that they revitalized transformation in their respective countries:

- In Colombia, which is plagued by civil war, a difficult political process began under President Uribe that was designed to overcome the deadlock in the violent conflict left by his predecessor, Pastrana. Despite the multidimensional challenges facing Uribe, he has achieved some success. However, several of his measures are controversial, particularly in terms of democratic development, and there is doubt as to whether his strategy will lead to a functioning market-based democracy in the long-term.
- The Bolaños government in Nicaragua owes its relatively high score primarily to its skills in international cooperation, which the country demonstrated to international development agencies particularly during the PRSP process and with the HIPC Debt Relief Initiative. Nicaragua's management score could have been higher, as Bolaños also convincingly pursued political reform. Indeed, his efforts led to the conviction of former President Alemán on charges of corruption. However, Alemán succeeded in avoiding punishment with the help of an agreement with the Sandinista leader Ortega. Essentially all substantial government initiatives were blocked and thus rendered the government incapable of taking action.

- Since assuming office in August 2003, Paraguay's President Duarte has overcome the rather muted success of his predecessor, González Macchi. The government immediately implemented several important proposed reforms (particularly in tax and social security policies) and began—in one of the most corrupt countries in the world—the fight against corruption in administration and the judiciary. The Duarte government also proved exceedingly more successful than all preceding governments in shaping international cooperation. This is all the more impressive when considering the fact that the government must act within the framework of a “divided government.”
- In Guatemala, the Berger government also shows only moderate management performance, yet it nonetheless demonstrates a clear improvement from its predecessor, Portillo. In contrast to Portillo, the Berger government has demonstrated, at least occasionally, a greater capacity for international cooperation. However, this trend is not particularly stable, as is the case with other reform trends in Guatemala. Consequently, Guatemala remains a potential site of crisis in Latin America, especially after the end of the UN mission (MINUGUA).

The gap between these relative success stories and those featuring clear failures of management is wide. A particularly dramatic example of regression is seen in Ecuador, where former military rebel Gutiérrez took over the presidency and the government in January 2003. Compared with his predecessor Noboa and his governance, political management under Gutiérrez deteriorated in all areas. Despite a recovering economy facilitated by the oil boom, Gutiérrez, who took office under the slogan of “good governance,” failed to implement any of his proposed plans. Instead, he resorted to the corrupt government policies of his predecessors and sought to outmaneuver democratic institutions. Following protracted protests, Gutiérrez was removed from power in March 2005.

Moderate success in the efficient use of resources continues to pose one of the greatest obstacles to significant gains in transformation. This moderate success is observed in all three indicators of resource efficiency: the inefficient use of financial and human resources, the inability to coordinate conflicting objectives, and limitations in fighting corruption. Only Chile can be compared in this respect with the top performers in Eastern Europe, or even with South Korea and Taiwan. Among the generally weak scores given for efficiency, one is particularly weak, namely the values given for fighting corruption. Corruption continues to represent one of the most significant obstacles to democratic and market economic progress. Only Chile, and to some extent Uruguay and Costa Rica, fight corruption earnestly. In all the other countries, public awareness has grown, as has awareness among at least some of the political elite. However, to date, integrity mechanisms in nearly all of the region's countries continue to function poorly or not at all. Even international organizations such as the World Bank, with their repeated calls to fight corruption, have acted thus far with little consistency and have sometimes exacerbated the inefficient use of resources.

Summary

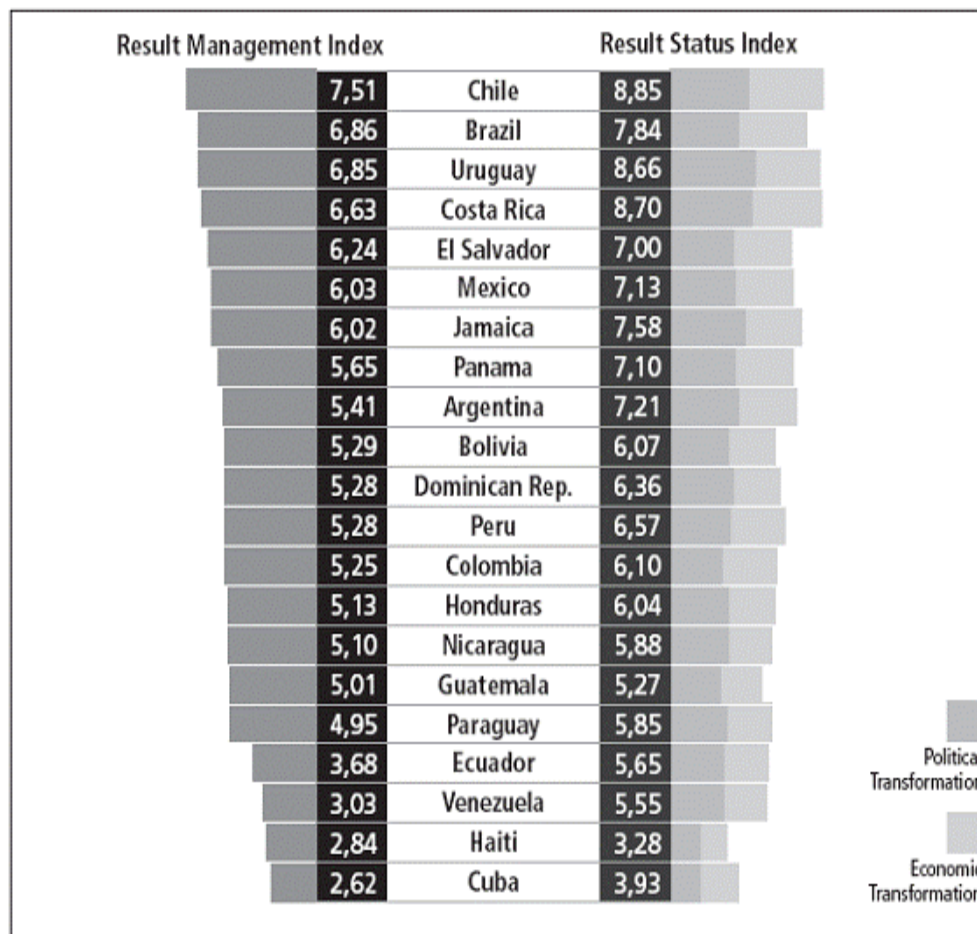
Democratic and market economic progress in Latin America has been limited in recent years. This may be attributed in part to the fact that Costa Rica, Uruguay and Chile had already achieved a relatively high level of transformation. Unfortunately however, most countries have shown stagnation and even regression in transformation. The staying-power of “illiberal defects” in most democracies poses the greatest problem and is linked with the difficulty in implementing a functioning rule of law.

With respect to market economic transformation, there were, on the one hand, visible signs of consolidation. On the other hand, there were also open conflicts over the social parameters of such consolidation. In Bolivia, this led to the sharpest domestic conflict about the “right” way between the market and the state which Latin America has seen in nearly twenty-five years. The

key protagonists of this movement include certain social movements (primarily in Bolivia, Ecuador and Peru) along with Hugo Chávez and Fidel Castro. It remains doubtful, however, whether this is announcing a paradigm shift in Latin American economic policy.

In terms of transformation management, Chile, Costa Rica, Uruguay, and, more recently, Brazil stand out in Latin America. Increasingly stable structures of good governance have emerged in these countries, increasing their ability to safeguard their democracies from neo-populist challenges. Apart from these, however, good governance in Latin America remains underappreciated among politicians and also often among citizens. Sporadic eruptions of public anger in dramatic events, like those observed in Argentina in recent years, soon give way to a general sense of lethargy. The slogan "Que se vayan todos" ("Out with them all!"), which heralded the Argentinian crisis of 2001, has been reduced to an empty cry, as nearly all of the politicians have remained at their posts. For some countries, this could lead to increased social unrest which will question the governability, as is the case already in Bolivia and Peru.

Results of the Bertelsmann Transformation Index 2006 for and the Caribbean and Latin America



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